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IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

DFA INVESTMENT DIMENSIONS GROUP INC., STATE STREET BANK & TRUST COMPANY, and PNC BANK, N.A.,

Petitioners,

v.

MUNFORD, INC.,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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Petitioners file this Reply Brief to deal with issues first raised in the Briefs in Opposition filed by Munford, Inc. ("Munford") and the United States Securities and Exchange Commission ("SEC").

I.

The Eleventh Circuit's Decision Is In Direct Conflict With The Tenth Circuit's *Kaiser Steel* Decision And Is Ripe For Review

Munford argues that this Court should not grant certiorari because the Eleventh Circuit's decision below does not "directly and substantially" conflict with the Tenth Circuit's decision in *In re Kaiser Steel Corp.*, 952 F.2d 1230 (10th Cir. 1991), *cert. denied*, 505 U.S. 1213 (1992). Munford, however does not deny that the *Kaiser Steel* decision and the instant case: (i) both involved the same type of merger, the same type of defendants, and the same type of plaintiff, (ii) construed the same provision of the Bankruptcy Code, Section 546(e); and (iii) reached directly opposite results. The SEC is even more forthcoming in its Brief in Opposition, acknowledging that "the two cases involved similar facts" and that "the courts reached different conclusions about whether Section 546(e) precluded the avoidance and recovery of payments made by a corporation to former shareholders in a buy-out merger." SEC Brief in Opposition 5.

Despite this undeniable conflict in result, both Munford and the SEC argue that this Court should not review this case because the two courts of appeals applied different reasoning in reaching their different results. A comparison of the issues and holdings of the two decisions demonstrates the error in this argument. At issue

before the two courts of appeals were decisions of district courts holding that Section 546(e) barred avoidance of LBO payments. *Kaiser Steel*, 942 F.2d at 1235; *Munford v. Valuation Research*, Pet. App. 10. In *Kaiser Steel*, the Tenth Circuit described its holding as follows: "We agree and, therefore, affirm the judgment of the district court." 952 F.2d at 1235. Conversely, the Eleventh Circuit concluded: "section 546(e) is not applicable since the LBO transaction did not involve a transfer to one of the listed protected entities. We conclude the district court erred with respect to this issue and reverse." Pet. App. 13.

Thus, each court addressed the same issue: whether the district court had properly applied Section 546(e) to exempt LBO payments from a trustee's (or debtor in possession's) avoidance powers. The courts answered this question differently, creating a direct conflict. The fact that the Tenth Circuit did not expressly address the Eleventh Circuit's reasoning that LBO payments are not "transfers" is irrelevant because the Tenth Circuit could not have reached its decision without rejecting this position. By its express terms, Section 546(e) only applies to a "transfer that is a . . . settlement payment." 11 U.S.C. §546(e). Therefore, in order for the Tenth Circuit to have held that LBO payments are exempt under Section 546(e), the court must have found that such payments were "transfers", rejecting the Eleventh Circuit's position. This extreme divergence in result and reasoning supplies an additional reason to grant the writ, so that this Court can supply needed guidance to the lower courts in the proper application of the statute.

The SEC, which supported Petitioners below, continues to agree with Petitioners that the Eleventh Circuit wrongly decided the case. SEC Brief in Opposition 8

("court of appeals' restrictive interpretation of the word 'transfer' in Section 546(e) is incorrect"). The SEC also recognizes that the decision below rests on an erroneous interpretation of Section 546(e) which calls for this Court's correction. SEC Brief in Opposition 6. Nonetheless, the SEC suggests that review by this Court is not necessary because "the matter is not presently ripe for review." *Id.* This argument suffers from the same infirmities as Munford's position. The instant case satisfies the criteria of this Court's Rule 10 because the Eleventh Circuit's decision is "in conflict with the decision of another United States court of appeals" on—by the SEC's own admission—the same important issue of federal statutory law. Nothing in the Rule 10, sound practice, or common sense would require that two lower courts use precisely the same analysis in reaching their opposing conclusions. A direct conflict exists because two courts of appeals applied precisely the same provision of the Bankruptcy Code to two virtually identical mergers and reached directly opposite conclusions.[1]

II.

This Case Involves An Important Issue of Federal Law

Munford erroneously argues that this case does not involve an important question of federal law and discounts the risk that recovery of payments for stock years

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[1] The SEC also argues that review by this Court is not warranted because the court below adopted its novel theory without benefit of briefing and argument. This circumstance provides no reason not to issue the writ, because the matter involves an important issue, as the SEC itself recognizes, and can be briefed and argued in this Court.

after the transaction may undermine confidence in the securities markets. Munford relies on the fortuitous rise in the stock market since the decision of the court below. This fortuitous circumstance does not detract from the fact, emphasized by the SEC in this Court and in the court below, that if the decision of the Eleventh Circuit were widely adopted and applied, it could undermine the effectiveness of Section 546(e) in achieving Congress' purpose of protecting participants in the securities clearance and settlement system and the efficient functioning of the securities markets. *See* SEC Brief in Opposition 8.

In fact, the issues raised in this case have potential application to every merger transaction involving public companies in the United States. The potential always exists that the merged company will not be successful, will declare bankruptcy and that a trustee will use a fraudulent conveyance theory to attempt to recover payments from former shareholders for their stock. While this circumstance does not occur every day, a major bankruptcy could cause serious disruption of the securities markets, a primary reason that Congress passed Section 546(e). The point, recognized by the SEC, is that a rule of law which permits a trustee in bankruptcy, years after the sale of stock, to unwind settled securities transactions by recovering payments made to shareholders in a public merger transaction could destabilize the clearance and settlement system. This circumstance is the exact result Section 546(e) was intended to avoid. A bankruptcy of a major player in the system clearly could negatively affect the entire system and it makes no difference whether the participant is a stockbroker, financial institution or customer. The failure of one participant, such as a customer, to fulfill its obligations can

cause others in the settlement process to be unable to meet their requirements, causing a failure of the entire system. Contrary to Munford's argument, it makes no difference whether the settlement and clearance system was directly or tangentially involved in the merger transaction. Section 546(e) protects the "system" by protecting transfers that are settlement payments made by or to one of the listed entities.

III.

Section 546(e) Should Be Applied According To Its Plain Meaning

In arguing that the Eleventh Circuit's decision is correct, Munford erroneously asserts that Petitioners urge an expansive interpretation of Section 546(e) which would not be appropriate to its purpose of protecting the nation's securities markets. Petitioners, however, seek only to have the statute applied according to its plain meaning. Section 546(e) by its terms prevents a trustee in bankruptcy or debtor in possession from recovering settlement payments such as those in this case, that were made either "by or to" one of the listed entities, except in cases involving actual fraud. Applying the statute according to its clear and unambiguous terms will provide certainty that settled securities transactions would not be reversed and thereby further Congress' general purpose to protect the nation's financial markets from instability caused by bankruptcies. *See* DFA Petition 19-24. In this regard, the SEC continues to support Petitioners, noting that the court of appeals' rationale "finds no support in the language or purposes of Section 546(e)", SEC Brief in Opposition 5, and that the "court of

appeals' restrictive interpretation of the word transfer is incorrect". SEC Brief in Opposition 8.

The Eleventh Circuit's decision regarding the proper application of Section 546(e) ignores the plain language of the statute and directly conflicts with the Tenth Circuit's decision. This Court should grant the petition to resolve this conflict on an important issue of federal law.

Respectfully submitted,

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